No. 82-1066

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

UNITED STATES OF AMERICA, *Appellant*,

v.

HARRY PTASYNSKI, *et al.*, *Appellees*.

On Appeal from the United States District Court for the District of Wyoming

BRIEF OF ASSOCIATION APPELLEES

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QUESTIONS PRESENTED

1. Whether exemption of oil production in most of the state of Alaska from taxation under the Crude Oil Windfall Profit Tax Act violates the constitutional requirement that excise taxes be uniform throughout the United States. U.S. Constitution, Article 1, Section 8, Clause 1.

2. If the tax is held unconstitutional, whether the extreme complexity of the windfall tax, the delicate political compromises embodied in the structure of tax rates, the need to balance production incentives with revenue generation, and the other significant policy considerations involved in determining whether the tax should be extended to Alaska, dictate that the proper remedy is to invalidate the tax in its entirety and thereby return to Congress the responsibility for restructuring the tax.*

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*The names of all parties in the Court whose judgment is being reviewed are set forth in the caption of the District Court opinion (J.S., 1a). None of the corporate parties has a parent company, subsidiary (other than a wholly-owned subsidiary) or affiliate.

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BRIEF OF ASSOCIATION APPELLEES

STATEMENT

The association appellees submit the following brief urging this Court to affirm the decision of the district court. The thirty-one association appellees include in their combined memberships most of the independent oil producers in the United States; they have direct experience respecting the origins of the Crude Oil Windfall Profit Tax, its subsequent revisions, the impact of the tax, and the difficulties of curing its constitutional defects. The other parties to this action have described the facts at great length, and further description would not aid the Court in resolving this case. Rather than duplicate arguments made in the briefs of the other appellees, the association appellees have limited their presentation to issues that may be particularly illuminated by the associations' unique perspective.

A. Operation of the Windfall Tax

The tax imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, 94 Stat. 229[1], is generally described in the Government's brief (Gov. Br. 2-5) and the brief of the Taxpayers. The complex "tier" structure of the windfall tax is displayed in a chart contained in the district court's opinion (J.S. App. 3a). Some further description is necessary, however, to adequately characterize the tax.

Although referred to as a "windfall profits" tax, the tax is in fact wholly unrelated to profit. The "windfall profit" is a statutorily defined amount, not a profit in the sense of after-cost earnings. The tax is levied upon individual barrels of oil at the time of production and removal from the property where the oil is produced. Because of this characteristic, the windfall tax is specifically identified by Congress as an excise tax. Section 4986(a). The tax applies only to domestically produced crude oil; it does not tax crude oil produced in foreign countries and imported into the United States. The windfall tax is the largest single tax ever adopted in the United States, 125 Cong. Rec. S16,842 (daily ed. Nov. 16, 1979). It is imposed on a group of taxpayers—domestic crude oil producers and royalty owners—comprising less than 1 percent of the total population of the United States.

Computation of windfall tax liability is exceedingly complex. The amount of the tax is determined by applying tax rates, varying from 30 percent to 70 percent, to the difference between the actual selling price of each barrel of oil and an arbitrarily determined adjusted base price. Section 4987. Both the tax rate and the base price vary depending on: (1) the category of the oil under the Department of Energy crude oil

[1] Hereinafter referred to as the "windfall tax" or "the Act." Provisions in the Act are hereinafter cited as codified in the Internal Revenue Code, at 26 U.S.C. Sections 4986-4998 (Supp. IV 1980 and Supp. V 1981).

price control regulations as they existed on either March 1, 1979, or June 1, 1979 (depending on which provision of the Act is being interpreted)[2], and (2) the classification of the owner as an independent producer, royalty owner, integrated company, or governmental entity. There are at least thirteen different categories of crude oil, four tax rates, and four classifications of producers. The adjusted base price is altered quarterly. Section 4989(a). The crude oil produced from a particular property, and even from a single well, can fall within several different categories and classifications for tax purposes.

The Act establishes numerous classifications of crude oil and several exemptions. All but the Alaska exemption are defined either by the identity of the owner of production (*e.g.*, governmental, charitable, and Indian exemptions)[3] or by the physical characteristics of the oil (*e.g.*, heavy oil)[4] or by the physical characteristics of the method or nature of production (*e.g.*, stripper well production)[5]. The Alaska exemption is defined solely by reference to geographic boundaries:

> (e) *Exempt Alaskan oil.*—For purposes of this chapter, the term 'exempt Alaskan oil' means any crude oil (other than Sadlerochit oil) which is produced—
>
> (1) from a well located north of the Arctic Circle or from a reservoir from which oil has been produced in commercial quantities through such a well, or

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[2] While the Department of Treasury administers and collects the tax, Section 4996(b)(8) incorporates by reference the Department of Energy Crude Oil Price Control Regulations, which are considered as continuing in effect for the life of the tax notwithstanding termination of crude oil price controls by Exec. Order No. 12287, 46 Fed. Reg. 9909 (1981).

[3] Section 4991(b).

[4] Section 4991(c).

[5] Section 4994(g).

(2) from a well located on the northerly side of the divides of the Alaska and Aleutian ranges and at least 75 miles from the nearest point on the Trans-Alaska Pipeline System.[6]

The vast area, both in terms of petroleum resources and of geographic size, exempted from taxation by this provision is described *infra* at pp. 8-10.

B. The Proceedings Below

This action was initiated by complaint filed October 14, 1980, in the Federal District Court for Wyoming on behalf of the Independent Petroleum Association of America, thirty other national, state and regional associations of producers and royalty owners of crude oil,[7] and several individual taxpayers

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[6] Section 4994(e), as amended by the Technical Corrections Act of 1982, Pub. L. No. 97-448, 96 Stat. 2365. The Technical Corrections Act corrected grammatical but not substantive defects in the language of the provision as originally adopted.

[7] American Association of Petroleum Landmen, Association of Oilwell Servicing Contractors, Eastern Kansas Oil and Gas Association, Liaison Committee of Cooperating Oil and Gas Associations, Arkoma Basin Independent Gas Producers Association, California Independent Producers Association, Illinois Oil and Gas Association, Indiana Oil and Gas Association, Independent Oil and Gas Association of West Virginia, Independent Petroleum Association of Mountain States, Kansas Independent Oil and Gas Association, Louisiana Landowners Association, Inc., Michigan Oil and Gas Association, New York State Oil Producers Association, Independent Oil Producers Tri-State, Inc., Independent Petroleum Association of New Mexico, Kentucky Oil and Gas Association, Ohio Oil and Gas Association, Panhandle Producers and Royalty Owners Association, Pennsylvania Oil and Gas Association, Tennessee Oil and Gas Association, Virginia Oil and Gas Association, Oklahoma Independent Petroleum Association, Pennsylvania Grade Crude Oil Association, Permian Basin Petroleum Association, Texas Independent Producers and Royalty Owners Association, and the West Central Texas Oil and Gas Association.

who sought windfall tax refunds. The States of Louisiana and Texas were subsequently granted intervention, and the trial court directed that the associations be designated intervenors with the individual taxpayers remaining as plaintiffs.

The Independent Petroleum Association of America is a national association of independent explorer-producers of domestic crude oil and natural gas. The combined membership of the thirty-one appellee associations represent virtually all of the 15,000 independent producers of crude oil and natural gas in the United States, together with many thousands of royalty owners. The explorer-producer members of the associations conduct approximately 90 percent of the wildcat exploratory drilling, drill 85 percent of all wells, and have discovered 56 percent of the present proven reserves of crude oil and natural gas in the United States.

After extensive briefing and lengthy oral argument, the district court found in favor of the plaintiffs/intervenors and against the Government. The court awarded refunds to the individual taxpayer plaintiffs and ruled that Title I of the Crude Oil Windfall Profit Tax Act was unconstitutional. In so ruling, it examined and rejected arguments identical to those which the Government presents here. (J.S. App. 7a, 9a, and 10a.)

SUMMARY OF ARGUMENT

The Crude Oil Windfall Profit Tax is an excise tax, Section 4986(a), and thus is subject to the constitutional requirement that excise taxes be uniform throughout the nation. U.S. Constitution, Article 1, Section 8, Clause 1 (the Uniformity Clause). This Court has interpreted the Uniformity Clause to require geographic uniformity in taxation. This requirement is clearly violated by the windfall tax, which is not geographically uniform since it fails to tax oil production in a vast region covering most of the State of Alaska. This area is entirely exempt from the tax burden that falls upon oil producers and royalty owners in the remainder of the United States.

The Uniformity Clause is one of the few limitations upon Congress's broad taxation powers. The requirement of uniformity has a sound policy basis—and provides true substantive protection for taxpayers. It discourages regional favoritism in the formulation of tax policies, and fosters the equal treatment of industries in various states. That there is a need for such protection is amply demonstrated by the adoption of the Crude Oil Windfall Profit Tax, the largest tax ever imposed on a single industry. The unconstitutional exemption of Alaskan oil production was essential to the passage of the tax. If uniform tax treatment had been required, the tax, if passed at all, would have emerged from Congress in a very different form.

The Alaska exemption is a major deviation from absolute uniformity. The exempt area alone is larger than any other state in the Union—and its exemption from taxation has already attracted hundreds of millions of dollars of oil industry investments that might otherwise have gone to different regions. This huge discrepancy resulted from a political combination of non-oil-producing states, joined by the State of Alaska, which harmed the vital interests of oil-producing states. Such a combination is the classic form of political conduct prohibited by the Constitution's Framers in the Uniformity Clause.

If the windfall tax is found unconstitutional, the proper remedy is to invalidate the tax as a whole, so that Congress can start afresh if replacement legislation is deemed necessary. Judicial extension of the tax to Alaska would raise complex policy questions because it would alter the crucial political compromise reached by Congress, it would violate fundamental principles of equity by taxing those who had invested in reliance on the Alaska exemption, and it would introduce further confusion and inconsistencies into the structure of the tax.

This brief also addresses certain inaccuracies in the Government's arguments regarding the legislative history and practical operation of the windfall tax, insofar as significant misconceptions might affect this Court's deliberations.

ARGUMENT

I. THE WINDFALL TAX IS AN EXCISE TAX IMPOSED ON CRUDE OIL PRODUCTION IN THE UNITED STATES BUT EXEMPTING OIL PRODUCED IN ONE REGION; THE TAX THEREBY VIOLATES THE CONSTITUTIONAL REQUIREMENT THAT "EXCISES SHALL BE UNIFORM THROUGHOUT THE UNITED STATES."

The constitutional challenge raised by the associations and the other appellees is extraordinarily straightforward. The language of the Constitution requires uniformity in excise taxation. U.S. Constitution, Article I, Section 8, Clause 1. The windfall tax is an excise tax, Section 4986(a)[8], which is defined in non-uniform geographic terms, since one portion of the country is exempt from taxation.[9] Therefore, as demonstrated in the briefs of the other appellees, the windfall tax on its face violates the Uniformity Clause.

In this section, the associations will highlight points that have not been fully addressed by other parties. First, the exemption of Alaskan oil is, in practical effect, a major deviation from a clear constitutional requirement. The exemption is the result of exactly the type of regional political dealing the Framers proscribed through the Uniformity Clause. The extremely burdensome financial and administrative requirements of the windfall tax are a significant detriment to producers in the non-exempt regions of the country, even though the amount of projected revenues has declined sharply in the past three years. Finally, the Government's attempt to avoid the uniformity requirement by identifying the subject of the tax as "windfall profits" rather than oil production is entirely in-

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[8] Section 4986(a) provides "An excise tax is hereby imposed on the windfall profit from taxable crude oil removed from the premises during each taxable period."

[9] Section 4994(e) (quoted *supra* at pp. 3-4) defines "exempt Alaskan oil," which is exempted from taxation under Section 4991(a) and (b).

consistent with the structure of the Act and with the basic characteristics of excise taxation.

A. The Alaska Exemption Represents a Major Deviation from the Constitutional Requirement of Uniformity.

By whatever measure the Alaska exemption is evaluated, it is a significant deviation from absolute geographic uniformity. Both the Jurisdictional Statement and Brief for the United States repeatedly refer to the Alaska exemption as a "North Slope" or "Arctic" exemption as though only a relatively small part of the State of Alaska is exempt. Such an implication is grossly misleading. The physical area encompassed by the exemption is vast, containing approximately three-fourths of the State of Alaska. (See map at Appendix A, *infra.*) The exemption is also enormous in terms of daily production and estimated future reserves.

The exempt area of Alaska—over 400,000 square miles—is *larger than any other single state*, and is larger than the *combined* size of the states of Maine, Massachusetts, Rhode Island, Pennsylvania, New Hampshire, Vermont, New Jersey, New York, South Carolina, North Carolina, Maryland, Delaware, Georgia, Connecticut, Virginia and West Virginia. Hammond, *The Whole Earth Atlas, passim* (1980).

Presently, oil is being produced from one oilfield in the exempt area, the Kuparuk River field, at the enormous rate of over 100,000 barrels per day. This production is estimated by the U.S. Geological Survey to increase to 250,000 barrels per day by 1986. *1982 Annual Report on Alaska's Mineral Resources*, U.S. Geological Survey Circular 884, at 17 (1982). Production from this oilfield alone is more than the total production of most states. Only the states of Texas, Louisiana, Oklahoma, California, Wyoming, and the non-exempt portions of Alaska produce more oil than the Kuparuk River field. Additional exempt production is expected soon from the Lisburne reservoir in the Prudhoe Bay field, and additional reserves are yet to be developed in the Kuparuk River field. *Kuparak to Become Second-Largest Oil Field in U.S.*, Oil and

Gas J., July 12, 1982, at 81. All of this is in addition to reserves already discovered in several areas offshore Alaska. See Brief *Amicus Curiae* of Atlantic Richfield Company at 2. Conoco has made two recent discoveries in the exempt area at Gwydyr Bay and Milne Point, each thought to be capable of producing about 50,000 barrels per day. *ARCO Alaska Begins Kuparuk Pilot Waterflood*, Oil and Gas J., March 14, 1983, at 38.

The State of Alaska estimated that 10.2 billion barrels of recoverable oil had been discovered on Alaska's North Slope as of August 1980.[10] National Petroleum Council, *U.S. Arctic Oil & Gas* 10 (1981). An additional 24 billion barrels of undiscovered recoverable oil were predicted to be present. *Id.* These oil reserves amount to almost 50 percent of undiscovered recoverable resources in the entire United States. *Id.* at 20. These figures include a high percentage of offshore resources, but do not include estimates for onshore areas south of the Arctic Circle, where the Bureau of Land Management is studying millions of acres for oil and gas leasing pursuant to the Alaska National Interest Lands Conservation Act, 16 U.S.C. Section 3148 (Supp. V 1981). *Oil and Gas Leasing Program for Non-North Slope Federal Lands in Alaska*, Department of Interior Ann. Rep. (1982).

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[10] The richness of Alaska's already commercially producing petroleum reserves is indicated by the state's distribution of cash payments to citizens of the state, as a direct result of revenues from oil production. See Alaska Permanent Fund Corp., 1982 Annual Report and Financial Statements 11 (1982). The original distribution scheme was stricken in *Zobel* v. *Williams*, 102 S. Ct. 2309, 2315 (1982), wherein this Court described the rapid growth of Alaska's petroleum revenues:

> The 1967 discovery of large oil reserves on state-owned land in the Prudhoe Bay area of Alaska resulted in a windfall to the State. The State, which had a total budget of $124 million in 1969, before the oil revenues began to flow into the state coffers, received $3.7 billion in petroleum revenues during the 1981 fiscal year. This income will continue, and most likely grow for some years in the future.

102 S. Ct. at 2311.

The importance of Alaska as an oil producing state was frequently emphasized in the congressional debates on the windfall tax. The Senate and Conference reports specifically noted the importance of reserves in the Kuparak and Lisburne formations. S. Rep. No. 394, 96th Cong., 1st Sess. 43 (1979); H. Rep. No. 817, 96th Cong., 2d Sess. 102 (1980). See 126 Cong. Rec. H1842-43 (daily ed. March 13, 1980)(remarks of Rep. Young) (oil from Alaska has helped stabilize a steady ten-year decline in American production); 125 Cong. Rec. S17666 (daily ed. Dec. 3, 1979) (remarks of Sen. Stevens) (Alaska produces about one out of six barrels of all domestically produced oil, amounting to 1.3 million barrels per day); 126 Cong. Rec. S2772 (daily ed. March 20, 1980) (remarks of Sen. Bellmon) (Alaska is "probably the most promising province remaining in this country for developing domestic oil supplies").

The congressional decision to exempt Alaskan production created a significant area in which oil production was treated more favorably than in any other state. This vast geographic non-uniformity is directly contrary to the explicit standard of the Uniformity Clause.

B. The Windfall Tax Is the Result of Actions By a Combination of States Which Strike at the Vital Interests of a Minority of States.

The Uniformity Clause requires that "wherever a subject is taxed anywhere, the same must be taxed everywhere throughout the United States and at the same rate." *Knowlton* v. *Moore*, 178 U.S. 41, 84 (1900). A tax must operate "with the same force and effect in every place where the subject of it is found." *Head Money Cases*, 112 U.S. 580, 594 (1884). The Government seeks to imply exceptions into the Constitution's straightforward rule. *Inter alia*, it urges that the Uniformity Clause was designed only to prevent majorities of states from oppressing minorities, and thus an exemption for only one state cannot violate the Uniformity Clause. This interpretation is clearly inconsistent with the historical reasons for adop-

tion of the Uniformity Clause and with unambiguous judicial precedent.

Even if the Government were correct in its assertion that the Uniformity Clause operates only when a majority of states oppresses a minority[11] the windfall tax would nevertheless violate the Uniformity Clause. The legislative history[12] confirms that those states with little or no crude oil production (which thus would bear little or no tax burden), along with the state of Alaska, combined to enact a tax that would be borne to an exceedingly disproportionate degree by the few states with significant amounts of crude oil production.

The windfall tax was approved by the House of Representatives on a vote of 302 in favor to 107 against. 126 Cong. Rec. H1861 (daily ed. March 13, 1980). Of the 435 congressional districts in the United States, only 170, including Alaska, have any oil production.[13] Many of these have only nominal amounts of production. The presence or absence of oil production in a state or district appeared to be a significant factor influencing votes on the windfall tax. In the Senate, the windfall tax was approved by a vote of 66 in favor to 31 against. 126 Cong. Rec.

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[11] The Uniformity Clause is also intended to prevent the granting of preferences to particular states or regions. J. Story, *Commentaries on the Constitution of the United States*, 683 (4th ed. 1873). See discussion in La. Mot. to Aff. 5-8.

[12] Congressional debates on the windfall tax are detailed in the Taxpayer and Association Appellees Mot. to Aff. 23-28, and in the briefs of the taxpayer appellees and the States of Louisiana and Texas. An excellent discussion of the windfall tax, its legislative history and underlying concepts, and the characteristics of the domestic petroleum industry is found in Drapkin & Verleger, *The Windfall Profit Tax: Origins, Development, Implications*, 22 B.C.L. Rev. 635 (1981).

[13] *The Almanac of American Politics, 1982*; Independent Petroleum Association of America, *The Oil Producing Industry In Your State* (1982).

S3151 (daily ed. March 27, 1980). As in the House, voting in the Senate also appeared to be influenced by the presence of oil production in a state. In fact, thirteen of sixteen senators from the eight top oil producing states voted against the tax.

Notwithstanding the large number of states and congressional districts without significant oil production, passage of the tax in the Senate remained blocked until a political deal was struck which assured the exemption of new production in the State of Alaska. The Acting Minority Leader of the Senate at the time, Senator Stevens of Alaska, played a key role in first blocking and then permitting consideration and passage of the tax by the Senate. See 125 Cong. Rec. S17707 (daily ed. Dec. 4, 1979); 125 Cong. Rec. S18041 (daily ed. Dec. 7, 1979); 125 Cong. Rec. S18564-65 (daily ed. Dec. 14, 1979). Without his cooperation, it is likely that no tax would have passed the Senate. See 125 Cong. Rec. S18041 (daily ed. Dec. 7, 1979). These aspects of the legislative history lead to the conclusion that passage of the windfall tax was indeed the result of a combination of non-oil-producing states, with significant assistance from the Alaska delegation in exchange for the Alaska exemption.[14]

This Court has consistently interpreted the Uniformity Clause to proscribe regional favoritism and to secure equal treatment for business development in each of the states. As this Court stated in its first consideration of the Uniformity Clause, *Hylton* v. *United States*, 3 U.S. (3 Dall.) 171, 180 (1796), the Clause required that "[t]he articles taxed in one state should be taxed in another . . .; *in this way the pressure on industry will be equal in the several states*. . . ." In other words, one state should not be given an advantage over another state in its ability to attract industry and new invest-

[14] More detailed discussions of the importance of the Alaska compromise in congressional passage of the windfall tax are contained in the Taxpayers and Associations Mot. to Aff. 23-28; Louisiana Mot. to Aff. 18-19.

ment or to maintain existing industries in a viable fashion, or in its respective ability to extract local tax revenue from industries within its boundaries.

The very section from Story's *Commentaries* that is strongly relied upon by the Government (Gov. Br. 26-27), shows that a concern for equal business opportunity motivated the Constitution's Framers to create the Uniformity Clause:

> Unless duties, imposts, and excises were uniform, the grossest and most oppressive inequalities, vitally affecting the pursuits and employments of the people of different States, might exist. The agriculture, commerce, or manufactures of one State might be built up on the ruins of those of another; and a combination of a few States in Congress might secure a monopoly of certain branches of trade and business to themselves, to the injury, if not to the destruction, of their less favored neighbors . . . . New York and Pennsylvania might, by an easy combination with the Southern States, have destroyed the whole navigation of New England. A combination of a different character, between the New England and the Western States, might have borne down the agriculture of the South; and a combination of a yet different character might have struck at the vital interests of manufacturers.[15]

These same important concerns are raised by the combination that produced the windfall tax. Alaska's advantage over other oil producing states is illuminated by the Brief *Amicus Curiae* of the Atlantic Richfield Company. The Alaska exemption has attracted the investment from Atlantic Richfield of:

> [A]lmost $700 million in development of the Kuparuk River field, including transportation facilities, since enactment of the Windfall Profit Tax, and its current plans call for an ultimate investment of approximately $4 billion. *Atlantic Richfield has increased the scope of its Kuparuk*

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[15] J. Story, *Commentaries on the Constitution of the United States*, 683 (4th ed. 1873).

investments and accelerated their timing in reliance on the "Alaskan oil" exemption.[16]

These statements demonstrate that enormous investment resources were focused on Alaska as a result of the congressional declaration that new Alaskan production would not share the same tax burdens as similar investments elsewhere. Significant activities are either underway or planned within the exempt area.[17] The State of Alaska has been given a distinct advantage over the other producing states in attracting such investment.[18]

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[16] Brief *Amicus Curiae* of Atlantic Richfield Company, at p. 2 (emphasis added).

[17] See, *e.g.*, *ARCO Alaska Begins Kuparuk Pilot Waterflood*, Oil and Gas J., March 14, 1983, at 38; *North American Arctic*, Oil and Gas J., July 12, 1982, at 71; *North American Artic*, Oil and Gas J., April 13, 1981, at 63; Wall Street Journal, March 16, 1983, at 7, col. 1-3; New York Times, Sept. 30, 1982, at D5, col. 2; New York Times, Aug. 12, 1982, at D4, col. 6.

[18] The "ripeness" issue raised by the Government (Gov. Br. 40-42, 41 n.35, 42 n.36) is discredited by these investment realities, as well as by the facial non-uniformity of the Act. It is not necessary for a determination of constitutionality to await the occurrence of any external event when it is apparent that the Act will operate without the requisite geographic uniformity. However, it is clear that injury was caused by the non-uniformity even before commercial production commenced in the exempt Alaskan area. Injury from unequal investment opportunities occurred long prior to the time that commercial production began. See affidavit of Kye Trout, attached to Motion of Taxpayers and Associations for Summary Judgement (J.A. 52) describing Atlantic Richfield's long time periods of exploratory work prior to commercial production and noting that 71 discovery wells were drilled in the Kuparuk River field prior to the commencement of commercial production. See also Staff of Joint Comm. on Taxation, *The Design of a Windfall Profit Tax*, 96th Cong., 1st Sess., 21 (Comm. Print 1979).

The mere fact the Alaska exemption described by Section 4994(e) is phrased in terms of geographic landmarks other than the perimeter of the State of Alaska does not, as the government contends (Gov. Br. 27 n.31), excuse the lack of uniformity. Obviously the Arctic Circle, insofar as it has any relevance to the United States, exists wholly in the State of Alaska. Likewise, the other geographical terms defining the Alaska exemption occur only within Alaska. That the exemption is defined and indeed related solely to the geographic location of the oil is not and cannot be disputed. Indeed, the Government concedes:

> There can, of course, be no dispute that the exemption here at issue is geographically defined so as to exclude oil located in all of the 50 states except portions of Alaska. (Gov. Br. 28).

In economic terms, the Alaska exemption distorted the incentives for investment. Rather than encouraging investment in new oil production wherever it might occur (and wherever it might be developed most efficiently), Congress created disproportionate incentives for production in one part of the country. Although they would not have expressed their concerns in these terms, this was exactly the harm that the Founding Fathers feared when they adopted the Uniformity Clause. They recognized the ability of selective taxation to influence the direction of industrial and commercial growth. Although Congress is empowered to structure its tax policies to favor one industry over another, it cannot use blatant geographic discrimination to encourage an industry in one area and discourage it in another. The fear of such a preference for industrial development in one state, at the expense of similar development in other states, is exactly what prompted the Framers to include the Uniformity Clause in the Constitution.

C. Although Projected Revenues from the Windfall Tax Are Now Less Than One-Third of the Amount Originally Anticipated, the Windfall Tax Is Nevertheless a Heavy Burden on Oil Producers in the Non-Exempt Areas of the Country.

In order to fully describe the extent to which the non-uniformity of the Alaska exemption creates a major deviation from uniform nationwide tax treatment, it is necessary to examine the burden the windfall tax places on oil producers and royalty owners in other parts of the country. This burden includes not just a 30 percent to 70 percent tax liability on "windfall profits," but also includes immense administrative compliance costs. These administrative costs remain constant, even though tax revenues have fallen because of declining oil prices.

The Government's brief (Gov. Br. 12 n.16) discusses the magnitude of the windfall tax revenues involved, both with respect to amounts previously collected and projected revenues for the future. Interestingly, the figure quoted for projected revenues for the next five years—$50 billion—has now been revised downward by 50 percent to $30 billion during the next *six* years. Motion to Set Case for Oral Argument During the Present Term of Court, at 2. This downward revised estimate is in keeping with recent Department of Treasury projections which now predict that the windfall tax, rather than generating a minimum of $227 billion, is more likely to generate no more than $75 billion throughout its expected lifetime. Office of the Secretary of the Treasury, Office of Tax Analysis, quoted in Jennrich, *U.S. "Windfall Profits" Tax Seen Falling $152 Billion Short of Target*, Oil and Gas J., March 7, 1983, at 29.

When Congress adopted the windfall tax, it accepted projections of net revenue to the federal treasury averaging $20.7 billion per year in the period 1980-1990. These projections were based on the faulty premise that crude oil prices would increase dramatically throughout the time period, notwithstanding repeated demonstrations by the petroleum

industry and independent economists that decontrol of oil prices would result in *increased supplies* of crude oil and *decreased prices*. With crude oil prices having declined from around $40 per barrel to under $30 per barrel, events have demonstrated the fallacy of the assumptions underlying adoption of the tax.[19]

In contrast to these declining revenues, the extreme administrative burdens in complying with the tax have not abated. Passage of the complex Act presented producers, purchasers, royalty owners, and even tax collectors with an administrative nightmare. The complexities of the administrative process are illustrated in the schematic diagram attached as Appendix C. The Act is so complex that, although it has been in force for more than three years, the meaning of some of its most fundamental provisions remains unclear. Regulations to implement the tax are either totally unavailable, proposed but not

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[19] Although neither the U.S. Department of Treasury nor Congress has ever publicly disclosed the exact projections of crude oil prices upon which revenue estimates were based, information has been published concerning the total anticipated revenues annually and volumes of crude oil in each tax tier. With such information it has been possible to reconstruct the revenue generation model which reflects expectations of annual average per barrel crude oil prices as follows: 1980 - $37.30; 1981 - $41.17; 1982 - $45.27; 1983 - $49.59; 1984 - $54.12; 1985 - $58.84; 1986 - $63.74; 1987 - $68.92; 1988 - $74.52; 1989 - $80.57; 1990 - $87.11. These figures have been confirmed with Lyndon C. Smith, Economist, Joint Committee on Taxation, U.S. Congress, who provided the estimates of revenue set forth in the Conference Report, H.R. Rep. No. 817, 96th Cong., 2d Sess., 168 (1980). In fact, the average wellhead prices of domestically produced crude oil in the United States have been: 1980 - $21.59; 1981 - $31.77; 1982 - $28.52. Energy Information Admin., Monthly Energy Review, March 31, 1983, at 88. Prices early 1983 have declined further, to approximately $26.50. IPAA, Wholesale Price Report. Current prices thus only slightly exceed *half* what Congress expected the price level to be in 1983.

final, temporary but not yet proposed as final, or in dispute. To date there have been 48 separate notices published in the *Federal Register* regarding proposed rules, temporary rules, solicitations for public comment, public hearings on proposed rules, and corrections, clarifications, or amendments of all of the above. See Appendix B, *infra*. In addition, the list of revenue rulings, revenue procedures, general counsel memoranda, private letter rulings, and technical advice memoranda is massive.

One of the primary concepts that remains unsettled is the definition of the "property" from which the oil is removed. See, *e.g.*, Notice of March 1, 1983, Public Hearing on Proposed Regulation for Definition of Property, 48 Fed. Reg. 2800 (1983). Last year, the General Accounting Office found that:

> Being the basic determinate of tax tier, the property concept is the cornerstone of the windfall profit tax. As such, the definition and scope of the concept should be well established during the early stages of the windfall profit tax program. . . . There is, however, considerable uncertainty over various aspects of the property concept within both the IRS and the oil industry. Initial IRS examinations reflected inconsistent and inaccurate treatment of the property concept. . . . Uncertainty over the meaning of a cornerstone term promotes neither voluntary compliance nor effective IRS examinations. Thus, Treasury and IRS need to quickly resolve uncertainties over the property concept.[20]

In testimony to Congress concerning the difficulties in administering the windfall tax, the General Accounting Office stated the windfall tax reporting burden on first purchasers amounted to "a couple million pieces of paper a year." [21] The

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[20] General Accounting Office, *Report to the Secretary of the Treasury, Uncertainties About the Definition and Scope of the Property Concept May Reduce Windfall Profit Tax Revenues* (1982).

[21] *IRS Administration of the Windfall Profit Tax and U.S. Geological Survey's Oil and Gas Royalty Collection Activities: Hearings*

GAO description of the burden on the Internal Revenue Service was even more illustrative:

> In February 1981, IRS estimated that it would spend 877 staff years and $20 million in Fiscal Year 1981, and 1,056 staff years and $24 million in Fiscal Year 1982, to administer the [windfall profit] tax. These resources must be diverted from other IRS programs and, as a result, other programs will suffer. The diverted staff years themselves, while significant in number, understate if anything the impact of the reassignments on IRS' other programs since it will be drawing on its more experienced and skilled employees to deal with these complex matters.[22]

In examining the burdens imposed by the windfall tax and the inequalities created by the Alaska exemption, it is also illustrative to note that the costs of production in other parts of the United States can rival those in Alaska.[23] Particularly informative testimony was presented by the Commissioner of Revenue for the State of Alaska. He praised the proposal to exempt Arctic production, but urged that it be expanded to other high cost production, including areas outside of Alaska:

> [W]hile [the tax] prudently exempts Arctic production to provide an incentive for development, *it fails to do so for other areas with comparably high costs and risks.* In the deep-water OCS off Louisiana, a single production platform may run into hundreds of millions of dollars. One

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Before a Subcomm. of the Comm. on Government Operations, 97th Cong., 1st Sess. 13 (1981)(Testimony of William J. Anderson, Director, General Government Division, U.S. General Accounting Office). See also Wall Street Journal, April 22, 1981, at 1, col. 5.

[22] *Id.* at 5.

[23] These production cost figures are offered for illustrative purposes only. Whether or not Congress had a rational basis for treating Alaskan oil production differently from other oil production is not a relevant issue. The Uniformity Clause does not contain an exception allowing non-uniformity whenever Congress may be able to discern some difference between two regions. See Taxpayers and Associations Mot. to Aff. 9-12; Louisiana Mot. to Aff. 9-14.

exploratory well in the Baltimore Canyon may cost over $20 million, while a well in the Gulf of Alaska can easily be even more expensive.[24]

In debates on amendments to the Act, it was observed that the costs of drilling in onshore areas of the "Lower 48" are approximately $1 million for a 10,000 foot well and $10 million for a 20,000 foot well.[25] These drilling costs have increased over 350 percent since 1970. 127 Cong. Rec. S8069 (daily ed. July 21, 1981) (remarks of Sen. Bentsen). Senator Wallop pointed out, "[I]n the Overthrust Belt, wells that were once on an average 2,000 to 4,000 feet, and costing in the neighborhood of a half million dollars, now go to 12,000 to 17,000 feet and costing in the neighborhood of $4 million."[26] These expense figures must be evaluated in light of the fact that about nine of every ten wells are non-producing dry holes. 127 Cong. Rec. S8952 (daily ed. July 31, 1981) (remarks of Sen. Dole).

It is an unfortunate but hard fact that even though revenues generated by the tax are declining, the cost of administration, both to the industry and to the Treasury Department, remains essentially constant at an inordinately high level. The process of producing oil remains expensive throughout the nation. The drastic downward revisions in the projected revenues to be generated by the tax highlight the urgency and correctness of providing Congress an opportunity to reexamine the issue, to assess whether the Tax's administrative burdens and production disincentives are justified.

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[24] *Crude Oil Tax: Hearings on H.R. 3919 Before the Senate Comm. on Finance*, 96th Cong., 1st Sess., 916 (1979) (statement of Thomas K. Williams, Commissioner of Revenue, State of Alaska).

[25] S. Rep. No. 144, 97th Cong., 1st Sess., 186 (1981) (additional views of Senators Bentsen and Boren); 127 Cong. Rec. S8068-69 (daily ed. July 21, 1981) (remarks of Sen. Bentsen).

[26] 127 Cong. Rec. S8088 (daily ed. July 21, 1981). See also *Crude Oil Tax: Hearings on H.R. 3919 Before the Senate Comm. on Finance*, 96th Cong., 1st Sess., 400-01 (1979) (statement of E. L. Williamson, President, Louisiana Land and Exploration Co.).

D. The Windfall Tax Is an Excise Tax on Oil Production; It is Not a Tax on "Windfall Profits."

The Government offers a strained interpretation of the windfall tax in an attempt to avoid its lack of geographic uniformity. Rather than taxing oil production, the government contends: "[T]he subject of the windfall profit tax is the 'windfall profit' derived from oil production." (Gov. Br. 18.) Based on this view of the tax, the Government asserts the requirement of geographic uniformity is satisfied since windfall profits are taxed wherever they exist. It contends that because of high production costs, windfall profits do not exist in the exempt area of Alaska, but (presumably) do exist in every other area of the United States, and thus the tax has the practical effect of uniform operation. (Gov. Br. 19, 28.) However, this assertion runs afoul of the historical characteristics of excise taxation, the legislative history of the windfall tax, and the structure of the Act.

In Section 4986(a), Congress expressly declared its intent to create an excise tax, and this congressional assertion is entitled to judicial deference. See *Spreckels Sugar Refining Co.* v. *McClain*, 192 U.S. 397, 401-02 (1904). A profit, windfall or not, is not a proper subject for an *excise* tax. Congress's constant statements that it was establishing an *excise* tax thus contradict the Government's assertions that Congress meant to create something different—a tax on profits.[27]

[27] The Conference Committee Report states, "The windfall profit tax is a temporary excise, or severance, tax applying to domestically produced crude oil." Similar statements appear in the House and Senate committee reports. H. Rep. No. 304, 96th Cong., 1st Sess. 43 (1979); S. Rep. No. 394, 96th Cong., 1st Sess. 2, 29 (1979). H. Rep. No. 817, 96th Cong., 2d Sess., 92 (1980). The analogy to severance taxation further serves to clarify congressional intent. Severance taxes are usually imposed as a fixed percentage of the value of the product severed or, in the case of oil, on a flat rate per barrel. 2 CCH State Tax Guide ¶ 45-000 (2d ed.). See, *Commonwealth Edison Co.*

To the extent the profit from a transaction is used in determining excise liability, it is merely part of the mechanical process of measuring the amount of tax on a taxable right, privilege, or event.[28] Thus, in the present case, the "windfall profit" is merely one element in the formula for computing the excise tax. The "windfall profit" is the *measure* of the tax, crude oil production is the *subject* of taxation. This conclusion is strongly reinforced by the fact the windfall profit is not a "profit" as that term is ordinarily understood. It is a creature of the statute, totally unrelated to actual profits.[29]

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v. *Montana*, 453 U.S. 609, 612 (1981) (Montana tax levied on "contract sales price" of coal labelled as severance tax). Severance taxes do not ordinarily take into account whether mineral production resulted in a gain or loss to the producer.

[28] For example, in *Nicol* v. *Ames*, 173 U.S. 509, 519 (1899), the Court determined that an excise tax levied on sales at business exchanges was a tax "upon the privilege, opportunity or facility" and was "not laid upon the property at all, nor upon the profits of the sale thereof." Accord, *Bromley* v. *McCaughn*, 280 U.S. 124, 136 (1929); *Pollock* v. *Farmers' Loan and Trust Co.*, 157 U.S. 429 (1895), on rehearing, 158 U.S. 601 (1895); *Indian Motocycle Co.* v. *United States*, 283 U.S. 570, 574 (1929).

[29] The common idea of huge "windfall profits" accruing to the oil industry was entirely fallacious. Although the oil industry enjoyed a brief surge in profits in 1974-75, its long-term profit margin was hardly spectacular. A Citibank study found that oil company profits for 1968-78 were 13.9 percent, compared to 13.7 percent for total manufacturing. H. Rep. No. 304, 96th Cong., 1st Sess., 83 (1979) (Minority Views of Rep. Conable, *et al.*). A similar study by the Chase Manhattan Bank and Securities and Exchange Commission found that the oil industry's 10.8 percent profits for 1955-77 compared with 11.4 percent for all manufacturing. *Windfall Profits Tax and Energy Trust Fund: Hearings Before the Committee on Ways and Means, House of Representatives*, 96th Cong., 1st Sess. 622, 695 (1979). See also Saterdal and Marks, *Oil Industry Profits—Perception vs. Reality*, Mines Magazine 5 (March 1980). Since passage of the windfall tax, as a result of lower oil prices, general economic trends, and of the tax, the oil industry has experienced an

The Government's mistaken identification of the subject of taxation is also revealed by Congress's failure to consistently account for "differences in 'windfall profit.' " (Gov. Br. 18.) The Government asserts that Congress categorized oil for windfall taxation based not upon differences in the physical character and quality of the oil itself, but upon differences in profit margins. This assertion conveniently overlooks many exceptions. For example, several classifications are based not on the "windfall profit" but upon who owns the oil, *e.g.*, state and local governments, Section 4994(a), certain Indian tribes, Section 4994(d), National Petroleum Reserve Oil[30] and "front-end tertiary oil."[31]

Other exceptions disproving the Government's asserted concern with differences in profit margins are found in the windfall tax Conference Report. Several oil classifications are described which, under the standards urged by the Government, clearly are distinguishable by their lack of so-called "windfall profit" rather than their physical properties—but which Congress refused to afford special treatment. These include: (1) high watercut oil, *i.e.*, oil which can only be pro-

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economic decline. The number of drilling rigs in operation has declined by over half, from 4,530 at the end of 1981 to a current low of 1,956. Petroleum Information, *Energy Information*, June 14, 1982, at 4, and April 4, 1983, at 3.

[30] Section 4991(b). National Petroleum Reserve Oil is owned by the U.S. Government and produced from a Naval Petroleum Reserve.

[31] Section 4994. The front-end tertiary oil provisions are a perfect example of the extreme complexity and irrationality of the entire tax. Front-end tertiary oil does not mean, as one might expect, oil produced from a tertiary project. Instead, it is produced by ordinary means and is released from crude oil price controls if the owner thereof was an independent producer who owned a working interest in qualified tertiary property, 50 percent or more of the working interest in which was owned by persons who were independent producers for the last quarter of 1979. Sections 4993(d) and 4994(c).

duced in conjunction with water several times the volume of oil produced, (2) deep marginal oil, *i.e.*, oil produced from wells with average daily production in excess of the stripper well limit, but which are economically marginal due to the depth from which they are produced, and (3) Cook Inlet oil, *i.e.*, that produced in the Cook Inlet of Alaska.[32] H. Rep. No. 817, 96th Cong., 2d Sess., 92-93 (1980). In each of these cases, congressional analysis based on the presence or absence of windfall profits would have resulted in tax exemption or in extremely favorable tax treatment. These examples indicate that such a concern was not the overriding congressional motivation.

Specific provisions of the Act further clarify that the triggering event for imposition of the windfall tax is the removal of taxable crude oil. Section 4987 provides that the tax is imposed "with respect to any barrel of taxable crude oil." The tax is not imposed with respect to a windfall profit. Instead, the windfall profit forms the tax base. Section 4988 sets out the specific statutory formula defining the amount of "windfall profit." Windfall profit refers to the difference between the removal price of a barrel and the adjusted base price minus adjustments for state severance taxes. Section 4988(c) defines the removal price. If the oil is removed from the property where it is produced before sale (or under certain other circumstances), the tax is calculated using a constructive sale price. Section 4988(c)(3). Thus the oil may be taxed even when there is not yet

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[32] It is significant that most of the debate about the high cost of operations in Alaska centered on the Cook Inlet. This congressional debate was cited extensively by the Government in its trial court brief (Brief for the Defendant in Support of Its Motion for Summary Judgment 28-29) as justification for the "reasonableness" of Congress trampling roughshod upon the Uniformity Clause. The Cook Inlet is *not* within the exempt area. New production in Cook Inlet, although undertaken at the high costs cited in congressional debates, is subject to the same tax rates as the rest of the nation. See 125 Cong. Rec. S18109-10 (daily ed. Dec. 10, 1979) (remarks of Sen. Stevens), 125 Cong. Rec. S18111 (daily ed. Dec. 10, 1979) (remarks of Sen. Percy).

any "windfall profit." The event of removal of oil from the premises creates the occasion for the tax, not the event of receiving "windfall profits."

The Government's assertion that the tax is constitutional because it uniformly taxes "windfall profits" must be rejected. Analysis of the windfall tax and the underlying congressional intent reveal that the subject of taxation is production of crude oil. Since the excise tax is not imposed upon oil produced in most of Alaska, the windfall tax is not geographically uniform, and must therefore be declared unconstitutional.

The preceding discussions reveal that the windfall tax places a heavy burden on oil production in most of the nation, while favoring the same industry in another region. Even if the Government's assertion is correct that Alaskan production is more expensive than oil production in the Rocky Mountain Overthrust Belt, or Louisiana offshore areas, or California heavy oil areas, this does not justify the Alaska exemption from a constitutional perspective.

The Founding Fathers would not have endorsed preference for agriculture in New England merely because it was more risky and expensive than Southern agriculture. Likewise, the fact that oil can be produced more efficiently and less expensively in the "Lower 48" does not constitutionally justify penalizing those who have invested in more efficient production. The Founding Fathers viewed this type of regional favoritism as so destructive to the Union that it was specifically prohibited in the Constitution. The Alaska exemption violates this constitutional safeguard.

II. THE UNCONSTITUTIONALITY OF THE WINDFALL TAX ACT REQUIRES THAT THE TAX AS A WHOLE BE INVALIDATED.

The proper remedy for the unconstitutional lack of uniformity in Title I of the Crude Oil Windfall Profit Tax Act is to strike the invalid tax in its entirety. The legislative history of the windfall tax compels this conclusion and shows not only that

the Alaska exemption played a central role in reconciling competing policies and political forces, but that the Act, if passed at all, would have emerged far differently absent non-uniform tax treatment for Alaska. Such a conclusion is also compelled by sound precedent, which demonstrates that the Internal Revenue Code's separability clause, Section 7852(a), requires invalidation of the tax. Failure to strike the tax would deny taxpayers a meaningful remedy for unconstitutional taxation.

In the following section, the association appellees will again focus on those issues that may be particularly illuminated by their unique perspective.[33] The associations will illustrate that it is not possible to simply delete the unconstitutional provisions from the Act, because to do so would create significant inconsistencies in its structure. The associations will also clarify one common misconception, *i.e.*, that the windfall tax was enacted as one component of the decontrol of crude oil prices. Finally, the associations will discuss the reasons that the Court should refrain from grappling with the major policy questions raised by expanding the application of the windfall tax and should instead allow Congress to resolve these issues.

A. It Is Not Feasible to Simply Sever the Alaska Exemption Provisions; Extending the Windfall Tax to Alaska Would Create Inconsistencies and Unfairness in the Operation of the Act.

Merely eliminating the few statutory sections describing the Alaska exemption from the Act would fall far short of resolving the difficulties created by the exemption. The complex structure of the Act does not allow such simple surgery. Extending

[33] The legislative history of the windfall tax and separability case law are analyzed extensively in the briefs of the taxpayer appellees and the States of Texas and Louisiana. See also Drapkin & Verleger, *The Windfall Profit Tax: Origins, Development, Implications*, 22 B.C.L. Rev. 635 (1981).

the tax to Alaska would require the Court to either impose a tax that in some respects operates unfairly, irrationally, or contrary to congressional intent—or to rewrite portions of the Act. The latter alternative has been squarely rejected by this Court. *Marchetti* v. *United States*, 390 U.S. 39, 60 (1968); *Blount* v. *Rizzo*, 400 U.S. 410, 419 (1971). The former alternative is similarly unattractive.

Extending the windfall tax as it currently exists would create many practical and procedural difficulties. For example, given the importance of the Alaska exemption to the Senate's acceptance of *any* tax on new oil[34] and the Congress's subsequent reduction of the rate of tax on new oil, Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, Section 602(a), 95 Stat. 172, 337, the Court might have to decide at what rate Congress would have taxed new oil had it not exempted Alaskan oil. Since the version of the windfall tax bill originally considered by the Senate would have exempted *all* newly discovered oil, S. Rep. No. 394, 96th Cong., 1st Sess., 42-43 (1979), it is possible Congress would have preferred a complete newly discovered oil exemption to taxing Alaskan production. See 127 Cong. Rec. S8084 (daily ed. July 21, 1981)(remarks of Sen. Dole).

The "sunset" provision of the Act dramatically demonstrates an inconsistency that would result from judicial extension of the tax to previously exempt areas. The windfall tax is scheduled to begin phasing out over a 33-month period whenever the tax revenues exceed $227.3 billion.[35] A decision to eliminate the

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[34] Steps leading to the Senate's crucial compromise on the Alaska exemption are described in the Taxpayers and Associations Motion to Affirm at 23-28.

[35] Each producer's tax is reduced by 3 percent for each month starting with the later of January 1988 or the first month (but not later than January 1991) after the Secretary of Treasury determines the aggregate net windfall tax revenue will exceed $227.3 billion. Section 4990. See H. Rep. No. 817, 96th Cong., 2d Sess. 116 (1980).

Alaska exemption would increase the amount of revenue collected by the tax. This raises the question of whether the Court must increase the target revenue amount, $227.3 billion, required to terminate the tax. Although, as noted *supra* at pp. 16-20, the price for oil and consequent windfall tax revenues have been below those originally projected, if oil prices prove to be as unpredictable in the coming years as in the past three years, the current low tax revenues cannot be entirely depended upon to rectify the problem. If the Court leaves the $227.3 billion ceiling intact, and higher prices and the expanded tax base cause the tax to terminate prior to January 1991, the law will leave untaxed certain non-exempt crude oil Congress intended to tax, and overtax Alaskan oil Congress decided not to burden.

The total exemption of certain Alaskan oil was not the only congressional differentiation between North Slope oil and other oil. Between 1980 and 1982, Section 4996(d) treated non-exempt Sadlerochit oil differently from other tier one oil, due to effects of the Trans-Alaska Pipeline System tariff upon the wellhead price of Alaskan oil. See H. Rep. No. 817, 96th Cong., 2d Sess. 103 (1980). This special treatment was eliminated by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, Section 284. If the Court strikes down the Alaska exemption retroactively, it will have to decide whether the now taxable tier three Alaskan oil is entitled to the more favorable treatment previously granted Sadlerochit oil (since new Alaskan oil would also be transported through the Trans-Alaska Pipeline System) or whether new Alaskan oil would be treated the same as non-Alaskan tier three oil.

Another inconsistency created by the Trans-Alaska Pipeline System adjustment provision remains despite Section 4996(d)'s amendment. The removal price of Sadlerochit oil is to be determined on a monthly average basis, Section 4996(d)(1), rather than on a per barrel basis as for other oil. Section 4988(a). This provision originated in the method of accounting used for transportation via the Trans-Alaska Pipeline System.

Since the current exempt production in Alaska is likewise transported through the pipeline, Brief *Amicus Curiae* of Atlantic Richfield at 23, the Court would have to decide whether Congress intended the provision to apply to all oil using the pipeline.

The Government suggests the tier three designation for newly discovered oil will automatically be applied to production in the exempt area of Alaska on the assumption all production in that area would qualify for newly discovered oil status. A Department of the Treasury notice of proposed rulemaking, 47 Fed. Reg. 50,306 (1982), suggests that proposed revisions in the definition of "commercial quantities" and other newly discovered oil concepts might impact such definitions for exempt Alaskan production.[36]

The foregoing examples are illustrative of the many interrelated provisions of the Act that must be considered in determining whether to extend the windfall tax to exempt areas of Alaska if it is found unconstitional. The complexities caused by attempting to judicially redeem Congress's unconstitutional taxing scheme are further highlighted by examining the confusing array of alternative remedies offered by the Government: First, in the lower court, the Government argued that "the only possible extension of the Alaskan exemption that would not conflict with the intent of Congress would be to extend the exemption to production in all areas similar to the Arctic Circle or located more than 75 miles from a pipeline connection." Reply Brief for the Defendant United States of America and in Opposition to Motions for Summary Judgment at 10.

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[36] The preamble to the proposed revision to 26 C.F.R. Section 51, 4996-1 observes, "The regulations would provide guidance on the requirements for the qualification of crude oil as newly discovered oil, as well as a definition of 'commercial quantities' that affects . . . the exemption for Alaskan oil." 47 Fed. Reg. 50,306 (1982).

Second, in its brief on the merits before this Court, the Government indicates that an invalidation of the windfall tax should apply only to newly discovered oil, "because that is the only category of oil that is not taxed with absolute geographic uniformity." (Gov. Br. 12 n.15, 50 n.46.) Thus, the Government suggests, invalidating the tax imposed on tier three newly discovered oil, Section 4991(e), along with the Alaska exemption provisions, Sections 4991(b)(3) and 4994(e), would create absolute geographic uniformity and thereby resolve the constitutional problem.

Third, the Government's casual assertion that offshore Alaskan oil would not be subject to the Uniformity Clause (Gov. Br. 21 n.28) implies the Court can extend the tax to cover all Alaskan onshore production, with offshore production remaining exempt. Alternatively, the Government acknowledges that as a result of the Submerged Lands Act, 43 U.S.C. Sections 1301-1315 (Supp. IV 1980), oil produced less than three miles offshore might be under jurisdiction of the State of Alaska and therefore controlled by the unformity requirement. Thus the tax would be extended to include all Alaskan production except that more than three miles offshore. Finally, the Government's oft-repeated option, should the windfall tax be held unconstitutional, is to strike the Alaska exemption and thereby extend the tax to all production.

The process of choosing one of these alternative remedies will embroil the Court in the type of complex decisionmaking most appropriately left to Congress. The windfall tax should be stricken in its entirety. Congress can then, if it desires to enact substitute legislation, resolve the inconsistencies and choose a constitutionally permissible tax structure.

B. The Windfall Tax Was Not Enacted as a Component of Oil Price Decontrol.

One common myth about congressional consideration of the windfall tax needs to be dispelled, *i.e.*, that "Congress enacted the windfall tax as an integral part of the decontrol of domestic oil pricing." (Gov. Br. 12). The windfall tax was not, in reality,

part of a "package deal" that included oil price decontrol. The decontrol process was well underway at the time the windfall tax was enacted.

Oil price controls originated in President Nixon's wage and price freeze on *all commodities* during 1971, imposed under the Economic Stabilization Act of 1970, Pub. L. No. 91-379, 84 Stat. 796. The price controls on oil continued long after similar controls on other products were abandoned.[37] The Energy Policy and Conservation Act of 1975, Pub. L. No. 94-163, 89 Stat. 871, provided for mandatory price controls on crude oil through May 1979 with presidential discretion for extension of controls through September 1981. In 1977 Congress rejected an attempt by President Carter to couple decontrol of crude oil prices with a tax on domestic crude oil.[38]

In April 1979—a full year prior to enactment of the windfall tax—President Carter announced his decision to exercise his discretionary authority to phase out price controls, because "Federal Government price controls now hold down our own production, and they encourage waste and increasing dependence on foreign oil."[39] At the President's direction, the Depart-

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[37] Oil controls were later maintained under authority of the Emergency Petroleum Allocation Act of 1973, Pub. L. No. 93-159, 87 Stat. 627. The discrepancy between oil and other commodities, so far as price controls are concerned, is that the producers of other goods and services became entitled to sell at market prices long before producers of oil. If there was a windfall from "decontrol," it accrued to people selling everything other than crude oil.

[38] President Carter's offered legislation was the National Energy Act, H.R. 6831, 95th Cong., 1st Sess. (1977), which coupled decontrol with a "Crude Oil Equalization Tax." The proposal died without being enacted when the 95th Congress adjourned. See 3 Staff of the Joint Committee on Taxation, 95th Cong., 1st Sess., *Section-by-Section Description of H.R. 6831, The Administration's Tax Proposals Relating to Energy*, 22-23 (Comm. Print 1977).

[39] President's Energy Address to the Nation, 15 Weekly Comp. of Pres. Doc. 609, 610 (April 5, 1979). Legislation to impose a windfall

ment of Energy implemented phased deregulation of crude oil prices by administrative order published November 12, 1979, to become effective January 1, 1980. The preamble to the final rule summarized the steps already taken to implement the President's decision to decontrol oil prices:

> As a result of these steps, producers may currently charge market prices for all production from properties which qualify as newly discovered properties (Executive Order No. 12,153, 44 Fed. Reg. 48,949, August 21, 1979). Market prices may also be received for the incremental production resulting from a tertiary project (43 Fed. Reg. 33,679, August 1, 1978). In addition, we have provided for the gradual conversion of most lower tier crude oil to upper tier crude oil by October 1, 1981 (44 Fed. Reg. 25,168, April 27, 1979).
>
> As the final step in the President's program, we propose amendments to the price regulations which provided for the gradual removal of ceiling prices for upper tier crude oil between January 1, 1980 and October 1, 1981 (44 Fed. Reg. 50,605, August 29, 1979).[40]

By the time the windfall tax was passed, decontrol had already spurred new investment in the energy industry. The number of drilling rigs in operation had grown to a 23-year high. U.S. News and World Report, April 7, 1980, at 71, 73.

The House Report confirms this separation between decontrol and the windfall tax: "While the windfall profit tax is

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profits tax was proposed shortly thereafter, but interestingly, the expected revenues from this tax were only $0.2 billion in fiscal year 1980, $1.3 billion in 1981, and $2.0 billion in 1982. Message to the Congress, 15 Weekly Comp. of Pres. Doc. 721, 726 (April 26, 1979).

[40] Final Rule on Phased Deregulation of Upper Tier Crude Oil, 44 Fed. Reg. 66,186-87 (1979). It was this phased decontrol program which was brought to a conclusion in one step by President Reagan's issuance of Executive Order 12,287, 46 Fed. Reg. 9909, on January 28, 1981.

structured to be consistent with the proposed deregulation of crude oil prices, it is not contingent on decontrol and will apply even if some form of price controls is continued or reimposed." H. Rep. No. 304, 96th Cong., 1st Sess. 3 (1979).[41] The decontrol of domestic crude oil pricing was thus independent from imposition of a windfall tax. The Government's attempt to infer that decontrol depended upon enactment of a windfall tax must be rejected.

C. Sound Policy and Precedent Demonstrate That Congress Should Be Given the Opportunity to Start Afresh.

Courts have traditionally evidenced a reluctance to enter into the realm of policymaking where decisions require a careful weighing of competing values. The instant case presents issues that epitomize the critical, complex policy judgments peculiarly within the province of the legislature. Striking down the entire Act would prompt Congress to reevaluate the windfall tax to determine whether—in light of the tax's strong disincentives for oil production, the decline in expected revenues, and the complex administrative requirements that have befuddled federal tax collectors as well as private taxpayers—the Act should be reenacted without the Alaska exemption.

It is not the responsibility of the judiciary to rectify congressional violations of the Constitution by exercising the legislative taxing power. Under the appropriate judicial test, enunciated as recently as last year in *Zobel* v. *Williams*, 102 S.

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[41] Both the House and Senate committee reports on the windfall tax indicate it was as much a response to high world oil prices, determined by OPEC suppliers, as to decontrol. H. Rep. No. 304, 96th Cong., 1st Sess. 2 (1979); S. Rep. No. 394, 96th Cong., 1st Sess. 6, 27 (1979). The Act did not, however, impose a tax on oil produced in foreign countries and imported into the United States. Only domestically produced oil is subject to the windfall tax. Sections 4991(a), 4996(b)(3).

Ct. 2309, 2315 (1982), if it is evident Congress would not have passed the bill without the invalid portion, then the appropriate remedy is to strike down the entire measure and send it back to Congress to enact proper legislation. Since, as the district court concluded, the tax would not have passed in any recognizable form without the Alaska compromise (J.S. App. 9a), the proper remedy is to invalidate the tax as a whole.

The Alaska exemption was a necessary and integral compromise in the windfall tax balance between raising tax revenues and increasing domestic production. Every form of the windfall tax considered by the House and Senate as well as President Carter's original proposal contained an Alaska exemption of one form or another. In fact, the original bill contained none of the traditional tax exemptions for charitable institutions or state and local governments—its *only* exemption was for Alaskan oil.[42] Every subsequent piece of legislation either contained a specific Alaska exemption[43] or exempted all newly discovered oil, including Alaskan oil.[44] From its inception, the windfall tax was based on an unconstitutional foundation.

Every legislative session following adoption of the windfall tax has witnessed substantial retreats from the original scope of the tax. In 1980, Congress allowed a $1000 tax credit for royalty owners. Pub. L. No. 96-499, Section 1131(a)(1), 94 Stat. 2691 (1980). The Economic Recovery Tax Act of 1981,

[42] Reese and Black, *Comparative Analysis of Tax-Exempt Status for Federal Income and Windfall Profit Taxation*, in D. Crumbley and C. Reese, *Readings in the Crude Oil Windfall Profit Tax* 161, 196 (1982); The Crude Oil Windfall Profit Tax Bill of 1979, H.R. 3919, 96th Cong., 1st Sess., introduced May 3, 1979.

[43] H. Rep. No. 304, 96th Cong., 1st Sess. 30-31 (1980); 125 Cong. Rec. S18564-67 (daily ed. Dec. 14, 1979); H. Rep. No. 817, 96th Cong., 2d Sess. 102-03 (1980).

[44] S. Rep. No. 394, 96th Cong., 1st Sess. 42-43 (1979).

Pub. L. No. 97-34, 95 Stat. 172, provided expanded relief for royalty owners, exempted stripper well production by independent producers, and reduced the tax rate on newly discovered oil. Only one amendment increased tax revenues. Tax Equity and Fiscal Responsibility Act of 1982, Section 284, Pub. L. No. 97-248, 96 Stat. 324, 569.

The issue of taxation is one where this Court has expressed particular reluctance to substitute its judgment for that of Congress. "In this area of limitless factual variations, 'it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments.' " *Bingler* v. *Johnson*, 394 U.S. 741, 751 (1969), quoting *United States* v. *Correll*, 389 U.S. 299, 307 (1968).

This Court's general concerns in determining whether to invalidate an unacceptable tax in full or in part are set forth in *Marchetti* v. *United States*, 390 U.S. 39 (1968). The Court notes, first, that although it is obliged to give full recognition to congressional taxing powers, "we are equally obliged to give full effect to the constitutional restrictions which attend the exercise of those powers." 390 U.S. at 58. Furthermore, where the unconstitutionality of one aspect of the tax would preclude a significant congressional purpose in enacting the legislation and where the will of Congress in balancing the remaining policies is unclear, the Court should return the decisionmaking to Congress: "[T]he Constitution has entrusted to Congress, and not to this Court, the task of striking an appropriate balance among such values." *Id.* at 60.[45] Such concerns are particularly relevant where, as here, there is no explicit direc-

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[45] See also *Blount* v. *Rizzo*, 400 U.S. 410, 419 (1971); *District of Columbia National Bank* v. *District of Columbia*, 348 F.2d 808, 810 (D.C. Cir. 1965) ("It is not the function of the courts to upset the balances among interests deliberately arrived at by the legislature, for that choice is a legislative and not a judicial one . . . ."); The Federalist No. 78, at 467, 479-71 (Mentor ed. 1961).

tion from Congress respecting what it wanted done in the event the tax was found unconstitutional.[46]

The wisdom of the separation of powers, especially in the realm of taxation, becomes apparent if the Court considers its own limitations in amassing the economic and statistical information necessary for balancing complex energy policy factors and formulating an acceptable new windfall tax. Congress debated the windfall tax and its predecessor tax proposals for almost three years.[47] In the two years following enactment of the tax, Congress considered and adopted amendments further refining the balance embodied in the tax.[48] These extensive legislative deliberations cannot, of course, be duplicated in a judicial setting. It is thus institutionally wrong for the Court to "enact" a tax Congress did not pass.

Congress continues to contend with the political and economic forces that alter the appropriate balance of energy production incentives and taxation. An overriding concern in recent legislative sessions has been eliminating disincentives for new oil production.[49] The economic situation in the energy industry is far different today than it was when the windfall

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[46] Senator Long's isolated comment, 126 Cong. Rec. S3056 (daily ed. March 26, 1980), relied upon by the Government, is not determinative. If anything, Senator Long's comment read in its entirety shows Congress would not have enacted the tax without the Alaska exemption. For a fuller explanation, see Taxpayers and Associations Mot. to Aff. 27-28; Louisiana Mot. to Aff. 18-19.

[47] The National Energy Act, H.R. 6831, 95th Cong., 1st Sess. (1977) (proposing the "Crude Oil Equalization Tax"), was introduced in May 1977. The windfall tax was enacted in April 1980.

[48] Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172; Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, Section 284, 96 Stat. 324, 569.

[49] S. Rep. No. 144, 97th Cong., 1st Sess. 96 (1981). 127 Cong. Rec. S8084 (daily ed. July 21, 1981) (remarks of Senators Dole and Boren); 127 Cong. Rec. S8088 (daily ed. July 21, 1981) (remarks of Sen. Wallop).

profit tax was originally adopted. The price of oil has fallen far below the levels expected by Congress. The windfall tax has raised far less than the amounts predicted. See section I.C., *supra*.

Sound policy and precedent demonstrate that Congress should be given the opportunity to start afresh, particularly since recent oil price declines have proven the invalidity of basic assumptions underlying the windfall tax. Congress has a broad range of alternatives from which to select. Congress might elect to adopt a totally different tax or a totally different exemption or no tax at all. (Gov. Br. 12 n.15). With the wisdom gained from having observed the futile attempts of the Internal Revenue Service and oil producers to understand and implement the exceedingly complex structure of the tax, Congress might well decide to adopt a much more simplified tax. Having observed the significantly decreased revenues resulting from the combination of declining oil prices and the unique design of the tax, Congress might adopt a tax designed to raise a certain level of revenue regardless of oil price fluctuations. Under any circumstances it is clear the Court cannot know what Congress would have done initially or would do now. It is equally clear there are compelling reasons for providing Congress an opportunity to reconsider its objectives and the means chosen to achieve those objectives.

CONCLUSION

The judgment of the district court should be affirmed.

Respectfully submitted,

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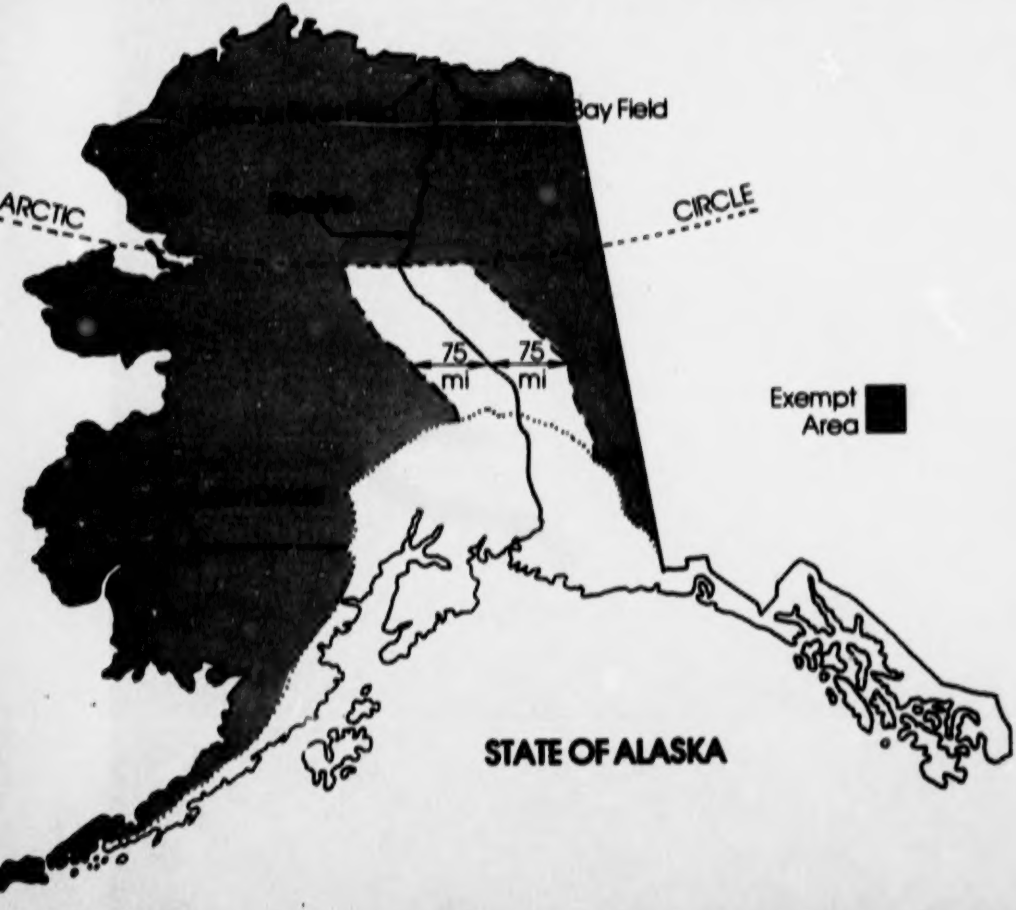
April 1983

APPENDIX A



Bay Field
ARCTIC
CIRCLE
75 mi
75 mi
Exempt Area
STATE OF ALASKA

APPENDIX B

FEDERAL REGISTER NOTICES RESPECTING THE WINDFALL PROFIT TAX

January-December 1980	January-December 1981
45 FR 203-205	46 FR 4873-88
45 FR 23384-99	46 FR 11284
45 FR 23400	46 FR 16257
45 FR 81606	46 FR 19935
45 FR 80551-53	46 FR 52334-39
45 FR 80554-55	46 FR 13509-11
45 FR 34899	46 FR 4950-51
45 FR 73512	46 FR 11292
45 FR 63297	46 FR 11947
45 FR 64603-604	46 FR 26660-61
45 FR 75231	46 FR 1754-58
45 FR 27953	46 FR 13525-26
45 FR 81561-63	46 FR 24595-96
45 FR 27929-33	46 FR 3560-61
45 FR 73467-71	46 FR 21307
45 FR 64574-78	
45 FR 78119	
45 FR 75206-208	
45 FR 63263-64	

<u>January-December 1982</u>

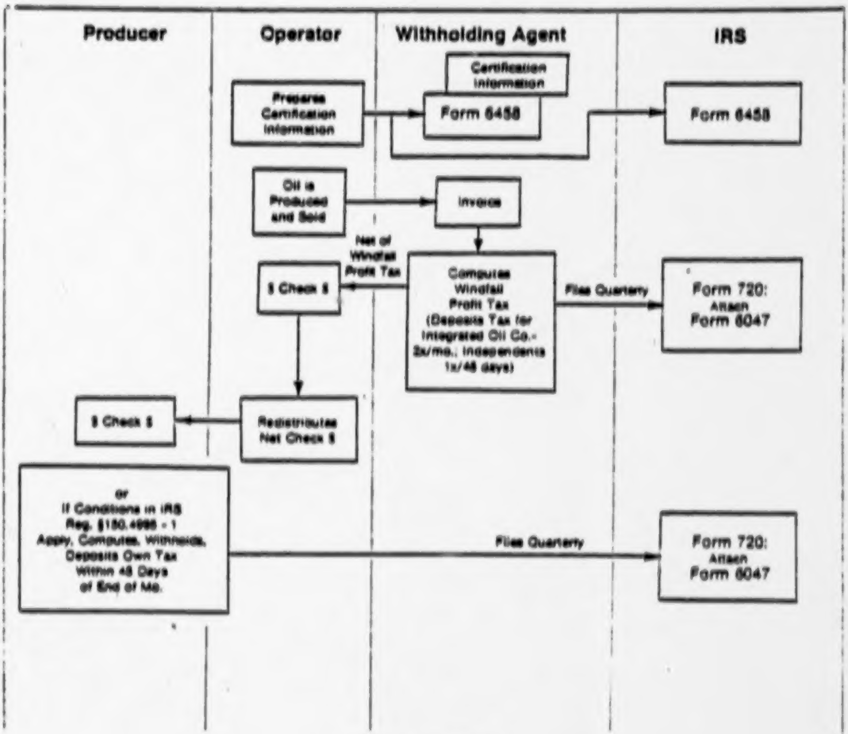
47 FR 50215-17
47 FR 8995-97
47 FR 50858-59
47 FR 50924-25
47 FR 9018
47 FR 50306-507

<u>January-December 1983</u>

48 FR 794
48 FR 1762-64
48 FR 1711-12
48 FR 2552-55
48 FR 2800-801
48 FR 3970
48 FR 5280
48 FR 10645

APPENDIX C

THE WINDFALL PROFIT TAX PROCESS



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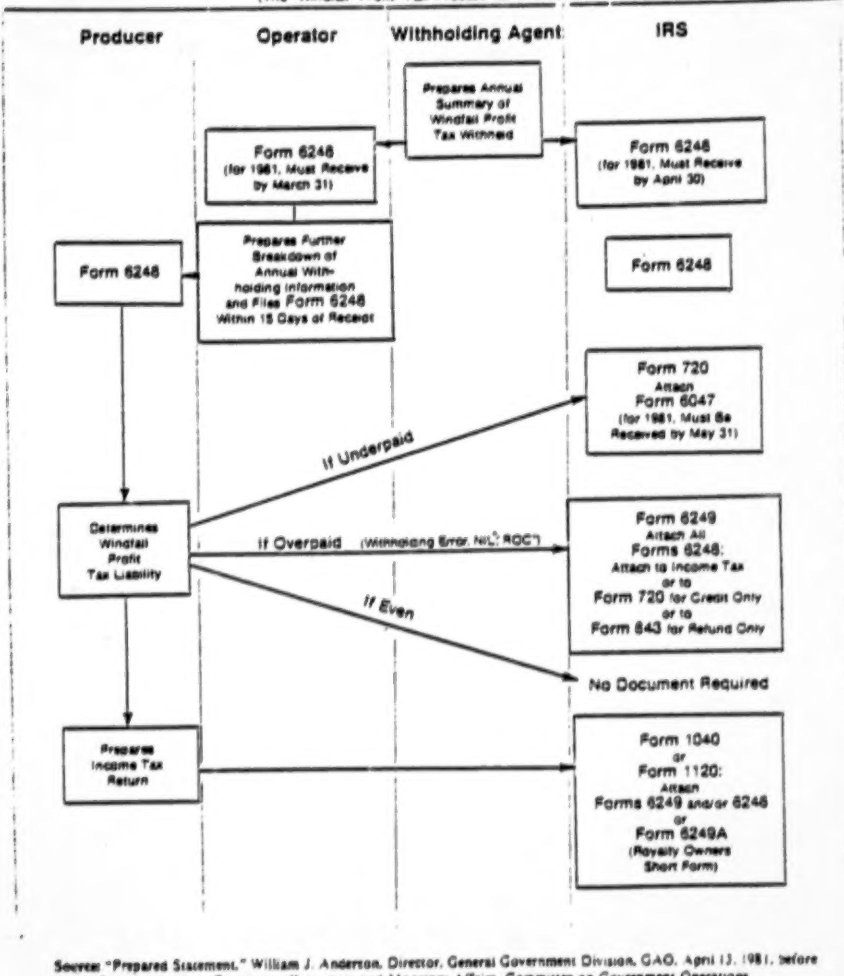
(The Windfall Profit Tax Process continued)



Source: "Prepared Statement," William J. Anderson, Director, General Government Division, GAO, April 13, 1981, before House Subcommittee on Commerce, Consumer, and Monetary Affairs, Committee on Government Operations.

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* Net Income Limitation, Royalty Owners' Credit.